MULTIMEDIA UNIVERSITY

STUDENT ID NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2019/2020

BFE2074 – FINANCIAL ECONOMICS

(All sections / Groups)

18 OCT 2019
9.00 a.m - 11.00 a.m
(2 Hours)

INSTRUCTIONS TO STUDENTS

1. This Question paper consists of **SIX (6)** pages, including the cover page and formula sheet.

2. There are **FOUR (4)** questions, attempt all of them. Each question carries equal marks; and distribution of the marks for each sub-question is given.

3. Please write all your answers in the answer booklet provided.

Answer ALL questions. Write your answers in the answer booklet provided.

Question 1

(a) Using the midpoint formula, calculate the

(i) elasticity of foreign exchange demand based on **Table 1** below when the spot exchange rate increases to 4.20RM/US$.

Table 1

Spot exchange rate	Price of Good X (per unit)	Quantity bought by Malaysia customers (units)
4 RM/US$	US$10	11
4.20RM/US$	US$10	10

(4 marks)

(ii) elasticity of foreign exchange supply in **Table 2** below when the spot exchange rate increases to 4.20RM/US$.

Table 2

Spot exchange rate	Price of Good X (per unit)	Quantity sold by American producers (units)
4 RM/US$	US$10	11
4.20RM/US$	US$10	12

(4 marks)

(b) Based on your calculations in part (a), determine in percentage change in the quantity of imports demanded and the quantity of exports supplied when the Malaysian currency depreciates relative to the US dollar by 1%.Categorize the consumers' type of elasticity with explanation towards changes in the exchange rate.

(6 marks)

(c) Based on **Table 1**, illustrate graphically the demand curve (illustrating the prices at both exchange rates) for:

(i) Good X (with Quantity of Good X on the x-axis and Price of Good X on the y-axis).

(2 marks)

(ii) The US$ (with Quantity of US$ on the x-axis and Spot Exchange rate RM/US$ on the y-axis).

(2 marks)

Continued...

(d) Based on **Table 2**, illustrate graphically the supply curve (illustrating the prices at both exchange rates) for:

(i) Good X (with Quantity of Good X on the x-axis and Price of Good X on the y-axis).

(2 marks)

(ii) The US$ (with Quantity of US$ on the x-axis and Spot Exchange rate RM/US$ on the y-axis).

(2 marks)

(e) Explain the elasticities approach to balance of payments and exchange-rate determination.

(3 marks)

[Total: 25 marks]

Question 2

(a) Explain the terms below.

(i) Discounted present value.

(2 marks)

(ii) Perpetuity bond.

(2 marks)

(iii) Interest rate risk

(2 marks)

(b) If a perpetuity bond pays RM500 per year infinitely, at a market interest rate of 5%, calculate the price of the bond.

(2 marks)

(c) If a perpetuity bond pays RM500 per year infinitely, at a market interest rate of 6%, calculate the price of the bond.

(2 marks)

(d) Based on your calculations in part (b) and (c), find the relationship between price of a bond and the nominal interest rate (assuming all other factors remain unchanged).

(2 marks)

(e) If a Singaporean firm has a franchise operation in Malaysia, what would happen to the Singaporean firm's current profits that year if the Ringgit Malaysia were to depreciate relative to the Singaporean dollars? Explain your answer.

(4 marks)

Continued...

(f) Compare and contrast **THREE (3)** types of derivative risks.

(9 marks)

[Total: 25 marks]

Question 3

(a) Differentiate between internal balance objectives and external balance objectives of economic goals of national policymakers.

(6 marks)

(b) Explain each type of unemployment below; supported by an example each.

(i) Frictional unemployment

(3 marks)

(ii) Structural unemployment

(3 marks)

(iii) Cyclical unemployment

(3 marks)

(c) Illustrate graphically the effects of an expansionary fiscal policy with a fixed exchange rate and low capital mobility. Examine if this situation creates a surplus or a deficit in the balance-of-payments.

(10 marks)

[Total: 25 marks]

Question 4

(a) Explain what it means by a closed economy and an open economy. Provide an example of country that is the closest or best describes each of these types of economy.

(6 marks)

(b) With a support of graphs, analyze the effect of an increase in the money stock on aggregate demand in an open economy with a fixed exchange rate and perfect capital mobility; where the bank sterilizes its interventions to maintain a fixed exchange rate. Will this situation lead to balance of payments surplus or deficit?

(15 marks)

Continued...

(c) From your analysis in part (b), analyze on the conclusion that can be made regarding a country's action to expand aggregate demand. Include different degrees of capital mobility and sterilized or unsterilized foreign exchange market operations in your answer.

(4 marks)

[Total: 25 marks]

End of Question

Formula Sheet

1. Elasticity of foreign exchange $= \left[\dfrac{\left(\dfrac{\text{New quantity - Old quantity}}{\left(\dfrac{\text{New quantity + Old quantity}}{2} \right)} \right) * 100}{\left(\dfrac{\text{New foreign exchange - Old foreign exchange}}{\left(\dfrac{\text{New foreign exchange + Old foreign exchange}}{2} \right)} \right) * 100} \right]$

2. $P_B = \dfrac{C}{R}$

3. $I = \dfrac{\left(R_1 + R_2^e\right)}{2}$

4. $r = r^*$

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